



# STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Draft

Date Amended:	04/01/04	Bill No:	AB 2472
Tax:	Sales and Use Insurance Income	Author:	Wolk, et al
Board Position:		Related Bills:	SB 1424 (Burton)

## BILL SUMMARY

This bill would create the California Tax Court to replace the Board of Equalization (Board) as the body to hear and determine appeals on sales and use tax, specified insurance tax, and personal income and corporation tax matters.

## ANALYSIS

### Current Law

Under existing law, the Board administers, among other things, the following tax and fee programs: sales and use tax, Bradley-Burns uniform local sales and use tax, transactions and use tax, alcoholic beverage tax, cigarette and tobacco products tax, motor vehicle fuel tax, diesel fuel tax, interstate user tax, emergency telephone users surcharge, energy resources surcharge, insurance tax, integrated waste management fee, natural gas surcharge, childhood lead poisoning prevention fee, oil spill response and prevention fee, underground storage tank maintenance fee, use fuel tax, marine invasive species fee, hazardous substances tax, California tire fee, occupational lead poisoning prevention fee, timber yield tax and private railroad car tax. The Board also assesses the property of public utilities and common carriers, and provides certain administrative and oversight functions with respect to the local property tax.

The Board comprises four elected members, one from each equalization district, and the State Controller. The Board itself is responsible for setting the values for the Board roll (utilities and common carriers). It also hears appeals relating to all of the taxes and fees it administers, as well as the taxes administered by the Franchise Tax Board (FTB).

### Proposed Law

This bill would amend specified provisions in the Sales and Use Tax Law, the Tax on Insurers, the Personal Income Tax Law and the Corporations Tax Law to provide that all petitions for redeterminations and/or appeals filed pursuant to those laws be filed with the California Tax Court, which this bill would create, within 90 days after service upon the person of notice thereof.

The bill would create the California Tax Court (Court) and would provide, among other things, the following:

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- The Court would consist of 5 judges appointed by the Governor and confirmed by the Senate, with term limits of 12 years, except as specified initially.
- Each candidate for a judge shall be a citizen of this country, a resident of California, and a licensed attorney that has engaged in the active practice of law with a primary focus on taxation for at least 5 of the 10 years preceding his or her appointment.
- The Court's principal office would be in Sacramento, but may hold hearings at any place within the state.
- The Court would be authorized to establish a streamlined hearing process for cases not in excess of \$10,000 (exclusive of penalties and interest).
- The decision of the judge holding the hearing is not subject to approval by the remaining members of the Court, however, the Chief Judge or the majority of the Court's judges, may determine whether such a decision should be decided by the entire Court.
- The taxpayer, or the Board, FTB, or the Insurance Commissioner may file an appeal with the Court within 90 days of the decision.
- The decision of the Court becomes final 90 days following its issuance of its decision.
- The Court's final action shall be considered res judicata with respect to any original action on a claim for refund filed in a state superior court.

### **In General**

In its December 2003 final report, the California Commission on Tax Policy in the New Economy<sup>1</sup> recommended that California establish a state administrative body to operate like the U.S. tax court. As an example, the Commission recommended an administrative body consisting of five administrative law judges, appointed by the Governor and confirmed by the Board or the Legislature, and that the administrative body would be formed under the legislative power, rather than a court with stature equivalent to the Superior Court. The recommendation further suggests that the administrative tax body consider *all* tax disputes, including personal income tax, corporate income tax, sales and use tax, property taxes, payroll taxes, and excise taxes.

On a separate note, Governor Schwarzenegger, on February 10, 2004, signed Executive Order S-5-04 creating the California Performance Review (CPR) to conduct a focused examination of California state government. Based on this examination and assessment, the CPR will formulate and recommend practical changes to government agencies, programs and operations to reduce total costs of government operations, increase productivity, improve services, and make government more responsive and accountable to the public.

The CPR has four major components as outlined in the Governor's Budget Summary 2004-05: (1) Executive Branch Reorganization; (2) Program Performance Assessment

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<sup>1</sup> This commission was created through the enactment of SB 1933 (Ch. 619, Stats. 2000), the purpose of which was to "create an open, public, fair and balanced participatory process for the development of a long-term strategy for revising state and local tax structure for California that eliminates needless complexity and nurtures and expands the state's global leadership in key emerging industries and for businesses that are repositioning to take advantage of the new economy."

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and Budgeting; (3) Improved Services and Productivity; and (4) Acquisition Reform. Teams of approximately 150 state workers, on loan from different agencies and departments, will examine these areas of state government. A California Performance Review Commission will also be created, which may consist of legislators, representatives from local government, other Constitutional officers, and other interested parties. The purpose of the Commission is to provide counsel, advice, and conduct public hearings to get input from the general public on the current performance of government operations and ways to improve that performance.

The CPR is to make its final recommendations to the Governor not later than June 30, 2004.

### **Legislative History of the Concept of a State Tax Court**

The following bills have been introduced over the years that proposed to create a state tax court or similar judicial body to hear tax appeals:

- **AB 2794 (Bowen, et al) of the 1995-96 Legislative Session**, would have abolished the FTB and, except as provided by the Constitution, the administrative authority of the Board, and would have provided for the transfer of their respective powers and duties to the Department of Revenue, which this bill would have created. This bill would have also created a Board of Tax Appeals consisting of seven members appointed by the Governor to serve as an appellate body to hear all tax appeals. This bill failed passage in the Assembly Revenue and Taxation Committee.
- **SB 1727/SCA 29 (Kopp) of the 1995-96 Session**, would have, among other things, done the following: (1) abolished the FTB and the Board and transferred their powers and duties to the California State Tax Authority, which this bill would create; and (2) created a Board of Tax Appeals consisting of seven members appointed by the Governor to serve as an appellate body to hear all tax appeals. Both bills were held in the Senate Appropriations Committee.
- **SB 87/SCA 5 (Kopp) of the 1993-94 Legislative Session**, would have, among other things, done the following: (1) abolished the FTB and the Board and transferred their powers and duties to the Department of Revenue, which the bill would create; and (2) create a Board of Tax Appeals. SB 87 failed on the Senate floor. SCA 5 was placed on the Senate inactive file.
- **SB 23 (Kopp) of the 1991-92 Legislative Session**, would have, among other things, done the following: (1) abolished the FTB and the Board and transferred their powers and duties to the Department of Revenue, which the bill would create; and (2) create a Board of Tax Appeals. This bill failed to move out of the Senate.
- **SB 1395 (Kopp, Ayala, et al.) of the 1989-90 Legislative Session**, would have, among other things, done the following: (1) abolished the FTB and the Board and transferred their powers and duties to the Department of Revenue, which the bill would create; and (2) create a Board of Tax Appeals. This bill failed passage in the Senate Appropriations Committee.

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- **SB 1685 (Kopp) of the 1991-92 Legislative Session**, would have, among other things, done the following: (1) abolished the FTB and the Board and transferred their powers and duties to the Department of Revenue, which the bill would create; and (2) create a Board of Tax Appeals. SB 1685 was sent to interim study. The Assembly Revenue and Taxation Committee held an oversight hearing on February 24, 1992, which reviewed specific issues related to consolidating the FTB and the Board into a Department of Revenue. The issues discussed included: administration, audit, collections, return processing, legal divisions/appeals process, facilities, and data processing. It was noted in the hearing that the state's budget crisis made consolidation less attractive at the time due to its costs and complexities.

## COMMENTS

1. **Sponsor and purpose.** This measure is sponsored by its author. According to the author's office, it is intended to, in part, carry out the recommendation of the California Commission on the New Economy. The author's office believes that by establishing an independent tax court, taxpayers would receive fair and equal treatment, and, that tax disputes would be resolved consistently as those resolved at the federal level.
2. **Arguments submitted to the California Commission on the New Economy in favor of a state tax court:**
  - Proponents state that creation of a tax court for California tax disputes would avoid the conflict that is inherent in combining the executive and policy making roles of the elected members of the Board, and would enhance the efficiency of the tax collection process by conforming dispute resolution with the Federal Income tax system. The stature of the Board as the central policy agency for California taxes would be enhanced by removing it from the dispute resolution process.
  - Proponents state that conformity with Federal legislation is a central policy goal in California tax legislation. Conformity with Federal procedures in tax dispute resolution with a matching dispute resolution process is consistent in that regard.
  - Proponents believe a centralized tax court would develop a consistent body of discoverable interpretative law, based on precedent, to serve as a guide to the application of California tax statutes. This measure would appoint judges with sufficiently long terms to provide consistency in the decision making process. Thus, the law would be applied based interpretation of the intent of the Legislature and the Governor, rather than on the basis of the policy views of independent elected officials sitting as judges.
  - Proponents also argue that a state tax court could develop a fairer and more accurate dispute resolution system based on rules of evidence, findings of fact, and application of the law to the facts as found. Also, a state tax court would result in

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cases more thoroughly considered by judges whose sole responsibility would be resolution of disputes brought before it, with a reduced reliance on staff expertise for final decisions.

**3. Arguments submitted to the California Commission on the New Economy against a state tax court:**

- Opponents note that under current law, Californians have a “tax court” option: the Board. The Board, in conjunction with the FTB, have settlement programs that permit taxpayers to pursue an administrative settlement process when seeking resolution of their tax disputes. The Board and FTB have qualified, professional staff available to the public. The existing structure is clear, and most importantly, provides for the public accountability of the elected Board Members. In contrast, there is no public accountability provision in the tax court proposal.
  - Opponents point out that at a time when budgetary constraints are of primary concern, any attempt to fragment the existing court system and to train and staff specialized courts with “tax law specialists” would be costly and time consuming. The current judicial structure provides for cost effective, flexible responses to Californians’ tax disputes.
  - Opponents argue that the creation of a state tax court would result in a fragmentation of the court system. The thrust of modern court administration has been to avoid such fragmentation, to consolidate courts, and to adopt common practices and procedures that permit efficient, flexible use of judicial staff and facilities. Courts of general jurisdiction can better meet demand, as the volume of litigation rises and falls within specific areas of the law.
  - Opponents state that the California court system has undergone major changes and evolution in recent years, including the establishment of a state funding process, consolidation of municipal and superior courts, transfer of responsibility for facilities to the state, and other changes. The judicial branch is currently working to implement these reforms, and there is no justification for further burdening the system with the structural changes necessary to establish a separate tax court.
- 4. The Board’s existing administrative process is working well.** The vast majority of petitions or appeals are resolved administratively. Of approximately 2,400 sales and use, insurance, and income tax appeals filed each year, an average of only about 17 cases are actually filed in the superior courts.

- 5. Is January 1, 2005 enough time to establish the tax court?** The provisions of the bill would become operative January 1, 2005, and as of that date, the bill would provide that petitions and appeals be filed with the California Tax Court. However, this would provide virtually no lead time in which to have judges selected and confirmed by the Senate. Where would the petitions/appeals be filed before the tax court is established? And, since interest on any unpaid liabilities continues to accrue

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after a petition or appeal is filed, taxpayers may be unfairly penalized for the interest accumulating during the time the California Tax Court is being established and in position to hold hearings.

6. **Board would still be empowered to consider claims for refund.** While this measure provides a judicial remedy for taxpayers filing petitions for redeterminations and appeals, the bill is silent with respect to claims for refund. Absent specific language, it appears the Board would continue to have jurisdiction over any claims for refund filed both before and after the determination is made by the proposed California Tax Court.
7. **A tax court following the same rules of practice as the United States tax court could intimidate taxpayers.** Although the bill would allow a taxpayer to represent himself or herself before the proposed tax court, due to the increased complexity that would be associated with the proposed the tax court, taxpayers may feel the need to hire highly specialized attorneys to navigate the rules of the court, especially considering the fact that relatively few attorneys or other practitioners that the tax court may allow are familiar with the United States Tax Court's rules of practice. Since the proposed tax court would be less accessible to taxpayers it would not provide more fairness or equitable resolutions for disputed tax cases.
8. **Related legislation.** Provisions similar to this bill are also contained in SB 1424 (Burton).

## **COST ESTIMATE**

Past legislative proposals have included creating a separate tax court that would hold hearings throughout the state. Each of these proposals would have required the appointment of judges who are certified tax specialists.

When these proposals were being considered in the early 1990's, the Judicial Council estimated that the costs of operating such a tax court could range from \$6.5 to \$7.5 million for a five-judge court. The present-day costs of operating such tax courts would be considerably higher. The cost would also depend on the structure and makeup of the tax court, including the standard for review and other applicable procedures, which are not specified in this measure.

## **REVENUE ESTIMATE**

This bill in and of itself would not affect the state's tax revenues.

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